

# **FACTORS OF ECONOMIC GROWTH IN ALBANIA**

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### **A panorama of Albanian economic performance**

The Albanian economy has been experiencing a yearly average growth of close to 6 percent in the last period. Since the beginning of its transition towards a democratic state and a free market economy in the early 90's, Albania's cumulative growth has been impressive and is considered amongst the highest in all transition economies. From 680 USD in 1990, real GDP per capita fell sharply during the early 1990s but has been growing steadily over recent years, to reach an estimated 2,882 in 2006.<sup>1</sup>

However, the country remains one of the poorest in Europe. Having started the transition from an extremely low level, the Albanian economy has still a lot to do in order to catch up with its neighbouring economies. Unlike some of the other countries of the East Block, Albania did not undertake any pre-transition reforms before the '90s. During 1991-1992 the economy encountered a sharp decline in output accompanied with high levels of unemployment and inflation. The adverse economic situation led to mass exodus of the work force abroad, especially to neighbouring countries, where Italy and Greece became the destination for most of the Albanian emigrants.

#### **GDP per capita in 2007, expressed in Purchasing Power Standards <sup>2</sup>**

Luxembourg	276	Germany	113	Slovakia	69
Norway	184	France	111	Hungary	63
Ireland	146	Spain	107	Lithuania	60
Switzerland	137	Italy	101	Latvia	58
Netherlands	131	Greece	98	Croatia	55
Austria	128	Cyprus	93	Poland	54
Sweden	126	Slovenia	89	Turkey	42
Denmark	123	Czech Republic	82	Romania	41
Belgium	118	Malta	77	Bulgaria	38
Finland	116	Portugal	75	Serb Republic	35
United Kingdom	116	Estonia	72	FYROM	29
<i>Source: EUROSTAT</i>				<b>Albania</b>	<b>22</b>

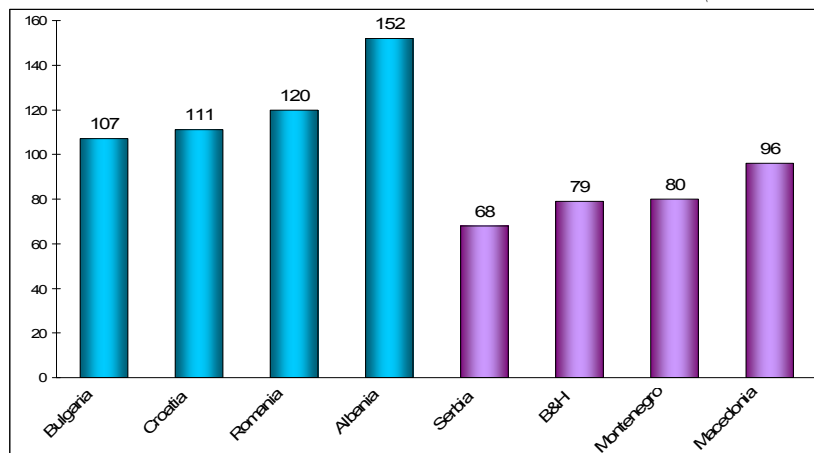
Immediately after transition, real GDP contracted sharply by a cumulative 39 percent between 1990 and 1992. Since 1993 the economy started an intensive recovery with growth rates of almost 10 percent. This was a combined result of successful macroeconomic stabilization, liberalization of prices and external trade, and privatization of agricultural land, as most of the growth during this period was driven by agriculture.

<sup>1</sup> INSTAT, Main Macroeconomic Indicators 1996 - 2006, at current prices.

<sup>2</sup>[http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP\\_PRD\\_CAT\\_PREREL/PGE\\_CAT\\_PREREL\\_YEAR\\_2008/PGE\\_CAT\\_PREREL\\_YEAR\\_2008\\_MONTH\\_06/2-24062008-EN-AP.PDF](http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP_PRD_CAT_PREREL/PGE_CAT_PREREL_YEAR_2008/PGE_CAT_PREREL_YEAR_2008_MONTH_06/2-24062008-EN-AP.PDF)

### Estimated\* level of real output in 2007 compared to 1989, in PPP

(1989 = 100)

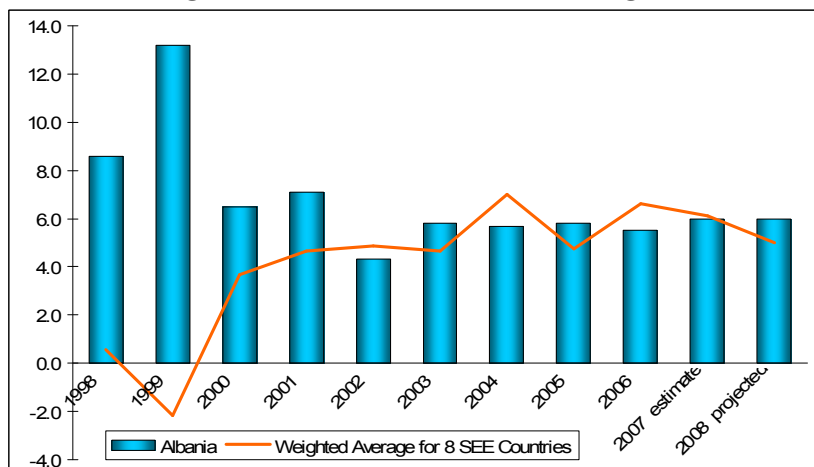


\* The weights used for calculating the index are EBRD estimates of GDP converted at PPP USD exchange rates in 1989

Data Source: EBRD, Transition Report 2007

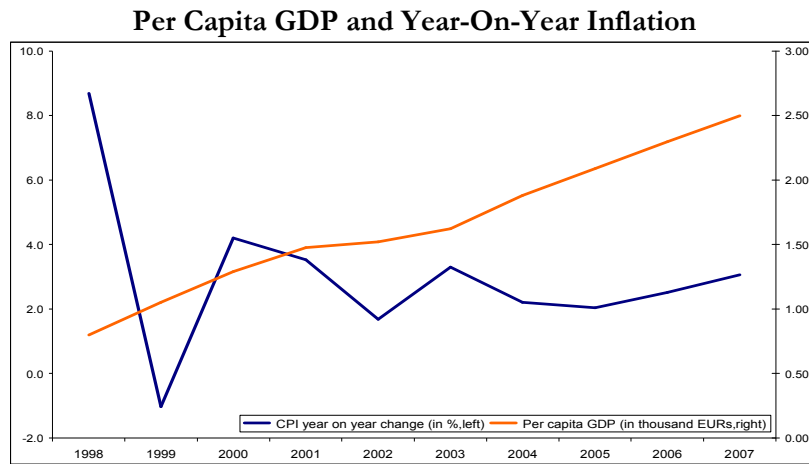
Albania's growth experience since transition can be divided into two separate periods. Year 1997 signed a sudden interruption of growth due to the collapse of the pyramidal savings schemes. The situation degenerated into a total domestic chaos while the economy contracted sharply by 7 percent in its real output. As a result of diligent policies of economic stabilization and a period of political stability in the immediate following years, the Albanian economy rerouted fast and achieved high positive growth rates starting from 1998, while in 1999 real GDP exceeded for the first time its level of 1990.

### Real GDP growth for Albania and SEE Average, 1998-2008



Data Source: EBRD, Transition Report 2007

Between 1998 and 2007 real GDP growth has averaged almost 7 percent yearly, amongst the highest in Eastern Europe. For the same period, only the Latvian and Estonian economy have shown an average real growth rate higher than Albania with less than one percentage point in difference. While, in relation to its closer neighbouring economies of South Eastern Europe, the average real growth rate for Albania marks the highest score.



*Data Source: INSTAT, Bank of Albania*

Inflation has remained quite stable during the same period, within the levels of 2 to 4 percent, which is also the target set by the Bank of Albania. The relatively high and sustained growth led to an estimated GNI per capita of almost 3,000 USD in 2006 upgrading Albania to the group of middle income countries.

***But, which driving forces underpin this economic performance?***

In order to interpret Albania's economic performance during the past years, the determinants will be grouped into three different bundles: macroeconomic policy, factors of productivity and expansion of consumption.

***On the policy level,*** macroeconomic stability has provided a favourable economic environment over most of the past years. A cautious fiscal approach has helped to consolidate the public finances by reducing the domestically financed government deficit from 6.74 percent of GDP in 1998 to 2.86 percent in 2005 and also by reducing the public debt to GDP ratio from 75 percent in 1998 to 55.5 percent in 2006. Prudent monetary policy has sustained price stability and rather steady inflation expectations while contributing to an elevated degree of confidence in the local currency LEK.

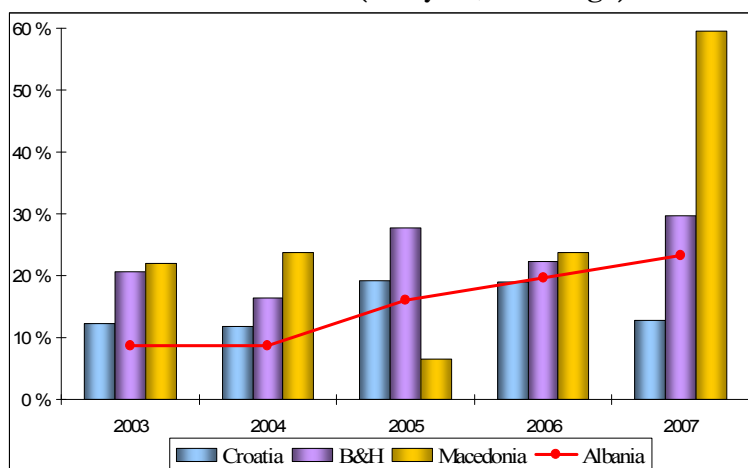
The second determinant of growth for Albania is ***total factor productivity***. During the initial years of transition, as expected, the chaos resulting from the removal of central planning and control produced a fall in economic output and the capital stock was idled. Consequently, as the economy achieved macroeconomic stability and introduced structural reforms, the reallocation of resources to more productive activities stimulated rapid growth with low rates of investment, allowing for total factor productivity (TFP) growth rates to increase. This has led to the reallocation of resources from low

productivity sectors like agriculture to high productivity sectors like services and construction. Mainly as consequence of improved allocation of resources, Albania's economic growth during transition has been driven primarily by high rates of total factor productivity growth. Growth accounting reveals that during the period 1993-2003, total factor productivity growth contributed 6.14 percent of the average annual real GDP growth of 6.27 percent, accounting for almost 98 percent of the total.<sup>3</sup>

Another important determinant of Albania's economic performance is the rapid **expansion of consumption**, following years of very restricted demand under the communist centralized economy. There are two main elements fuelling this expansion, **bank credit** and **remittances from emigrants**, but the latter is particularly specific for the Albanian case. In the case of credit to the economy, the situation does not offer any unexpected development compared to similar transition economies.

The remittances, however, appear to be specifically distinct. In order to put this in context, according to INSTAT calculations based on the latest population census of 2001, the number of Albanian emigrants accounted for more than two-thirds of the total number of persons employed in Albania. In terms of figures, the overall number of emigrants living and working abroad was calculated to amount to about 650,000<sup>4</sup> while the number of the domestically employed workforce was 920,000 for that same year. More or less the same trends have continued to present, with minor increases in employment figures and with similar expectations on migration.

**Domestic credit (end-year, % change)**



Data Source: EBRD, Transition Report 2007

Official estimates indicate that remittances are the largest source of foreign exchange in Albania, bigger than the combined value of exports and foreign direct investments. In 2005, remittances amounted to 14 percent of the GDP and 65 percent of Albania's trade

<sup>3</sup> World Bank Country Economic Memorandum, *Albania - Sustaining Growth Beyond the Transition*, PREM Unit, ECA Region, Report No. 29257-AL, (2005), pg.22 [Table 7: Albania Growth Accounting Results]

<sup>4</sup> INSTAT (2004) *Migration in Albania, Population and Households Census 2001*, pg. 36.

balance.<sup>5</sup> In absolute figures, the Bank of Albania estimates the level of remittances sent to Albania from abroad to be over 1.3 billion USD in 2007.

#### Inflow of remittances to Albania

in million USD

	1998	1999	2000	2001	2002	2003	2004	2005
Workers' remittances	452	368	531	615	632	778	1,028	1,161
<b>Remittances to GDP (%)</b>	<b>16</b>	<b>11</b>	<b>14</b>	<b>15</b>	<b>14</b>	<b>13</b>	<b>14</b>	<b>14</b>
Remittances to Trade Balance (%)	75	56	65	60	55	58	65	64

Source: Bank of Albania

In a nut shell, during the past years of Albania's transition, the high growth rates have been mainly fuelled by total factor productivity improvements and strong domestic demand, primary sustained through high levels of remittances sent from abroad. The economy has been driven by rapid expansion of consumption, following years of very restricted demand under the communist centralized economy, and of productivity growth as the old industries collapsed while a new service sector emerged, and workers migrated. Adequate monetary and financial policies encouraged a stable and therefore favourable economic environment.

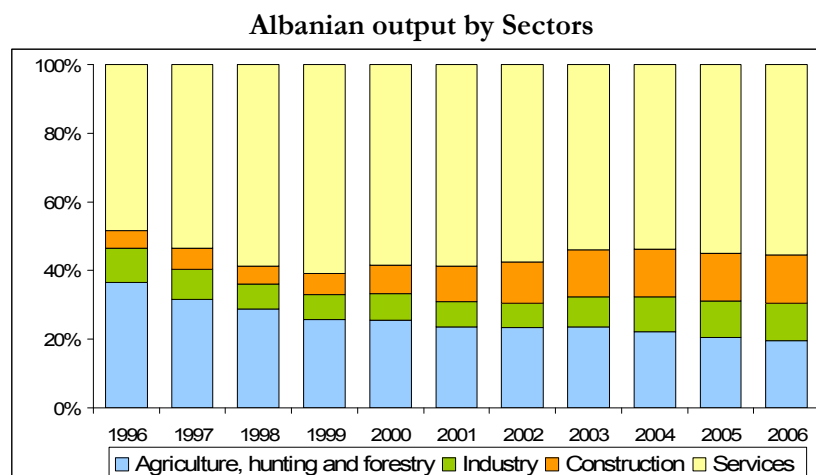
However impressive the Albanian economic performance, serious concerns arise in regards to the sustainability of these growth trends for the following years. Total factor productivity growth from post-transition reallocation will gradually come to an end while remittances cannot constitute a solid basis for long term economic development. The actual tightening of the global economy will pose additional threats which, together with the risks accompanying the internal factors of economic growth, necessarily call for a vigilant approach towards sustaining the recent year's positive trends in the Albanian economy.

<sup>5</sup> Bank of Albania, *Remittances: The Albanian Experience*. Available from [www.imf.org/external/np/sta/bop/2006/luxgrp/pdf/albani.pdf](http://www.imf.org/external/np/sta/bop/2006/luxgrp/pdf/albani.pdf), last checked on November 1, 2008.

### **Sectors supporting economic growth**

The four main sectors composing Albania's productivity are agriculture, industry, construction and services. During the last ten years, non-tradable sectors such as construction and services have constituted the main driving force of Albania's economic growth, counting together for almost two-thirds of the GDP in 2006.<sup>6</sup> There is still room for productivity gains in the non-tradable sector. In retail and distribution, where near-monopolistic price setting seems prevalent, there are opportunities for improved allocation of resources.

Agriculture constitutes the most important traditional sector. After an initial droop in early 1990s, Albanian agriculture experienced a prolonged expansion, which was mainly sustained by changes in incentives as people were moving from collective farms to private holdings. However, a number of constraints have been holding back further developments in the sector, some of which include fragmented land ownership resulting in small land size, limited use of modern inputs, poor infrastructure and low market access, weak processing capacity, and the absence of a proper land market. The slowdown in agricultural growth and the surge in the output of other sectors have narrowed its share of GDP to 21 percent in 2006 from its high of 35 percent in 1995. However, the importance of this sector remains still high as it constitutes the main source of income for nearly 40 percent of the Albanians.<sup>7</sup>



*Source: INSTAT*

The necessity for improving housing conditions, extending productive capacities and creating a modern infrastructure has encouraged the flourishing of the constructions sector. For some years, this sector was transformed into one of the surprises of economic development while doubling its GDP share in 2005 to amount to 16.5 percent compared to the previous year.<sup>8</sup> However, during the past year, the construction sector

<sup>6</sup> World Bank: Albania, Urban Growth, Migration and Poverty Reduction, December 3, 2007, pg 2

<sup>7</sup> INSTAT, Labor Market Indicators 1996-2006.

<sup>8</sup> Bank of Albania, Annual Report 2005, pg.14



has faced a considerable drop mainly due to a halt in permission granting by the authorities, plunging by 25 percent in terms of new constructions only during 2007.<sup>9</sup>

The services sector has been the most expending sector in terms of contribution to the country's total economic output. During the first years of transition the services sector became important especially with the expansion of trade, while more recently the banking system and retail sector have been the driving force behind the increase of the sector's share in the country's output. The numbers show a rapid and sustained growth of the services sector which, according to the Bank of Albania, constitutes the most dynamic sector of the Albanian economy.<sup>10</sup>

After the complete breakdown of the industry sector during the initial years of transition, the industrial production has been picking up slowly. Some of the constraints that have held back the industry sector are the lack of investments, little interest of domestic and foreign business, low profitability and high costs.<sup>11</sup> After the recent increases in the international mineral prices, the industry sector has picked up in minerals extraction and processing. Mineral exports, together with fuel and electricity, continued their recent surge in the second quarter of 2008, increasing by 87 percent year on year.<sup>12</sup>

### **Factors of productivity, the cocktail fuelling the economic engine**

Total factor productivity growth justifies the expansion of Albania's output, which for the entire period of transition accounts for over 80 percent of the total output growth.<sup>13</sup> Meanwhile, the contribution of factor mobilization and accumulation of capital has only picked up modestly and faces constraints. With consumption persistently high, domestic savings have declined after 2001. Both the migration of young workers and the modest savings rate will continue to limit the growth of factors of production, and confirm the need for finding new sources of TFP growth.

**Sources of Growth in Transition Economies, 1993-2007**

		Cumulative Real Growth	Contribution to growth		
			TFP	Capital	Labor
<b>Albania</b>		<b>96.1</b>	<b>80.5</b>	<b>20.9</b>	<b>-5.1</b>
17 transition economies		49.8	49.0	4.8	-4.3
<i>Of which:</i>	Baltic States	73.5	73.2	11.7	-11.1
	CEE Countries	51.3	45.6	8.7	-2.9
	PRGF transition economies	37.9	43.0	-5.9	0.9

Source: IMF

The neoclassical growth model underscores the important role of investment, school enrolment, trade integration, and institutional quality in economic growth. In such a

<sup>9</sup> Bank of Albania: Financial Stability Report 2007, pg. 32

<sup>10</sup> Bank of Albania: Monetary Policy Statement for the first half of 2008, pg. 10

<sup>11</sup> Bank of Albania, Annual Report 2005, pg.12

<sup>12</sup> The Economist Intelligence Unit, Country Report, September 2008, pg.20

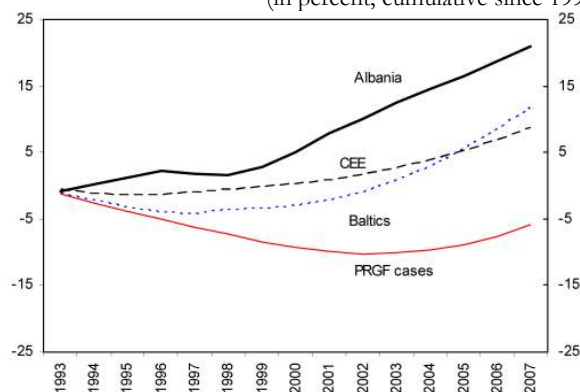
<sup>13</sup> IMF, Country Report Albania, Report No. 08/267, August 2008, pg. 12.

model, investment and school enrolment rates are key determinants of the steady-state level of output per worker. Given current levels of output per worker, a higher steady-state level will generate faster growth. Another important element is the level of technology, which can itself depend on the degree of trade integration and the quality of institutions.

In an attempt to understand the factors that lie behind the TFP growth for Albania, the determinants can therefore be grouped into four categories: capital accumulation, education enrolment rates, the degree of trade integration, and institutional quality. Since specific developments for each of these determinants will play a crucial role in Albania's economic future, let us take a closer look at each of the groups of determinants.

The contribution of **capital accumulation** to growth during most of the transition in Albania has been negligible, only to pick up in the last period. According to the IMF and World Bank calculations, the contribution of capital accumulation to growth started to steadily increase after 2002.<sup>14</sup> From the graph below, becomes evident that what sets Albania apart from other transitioning economies is the high and growing contribution of capital accumulation.

**Contribution of Capital Accumulation to Growth**  
(in percent, cumulative since 1993)

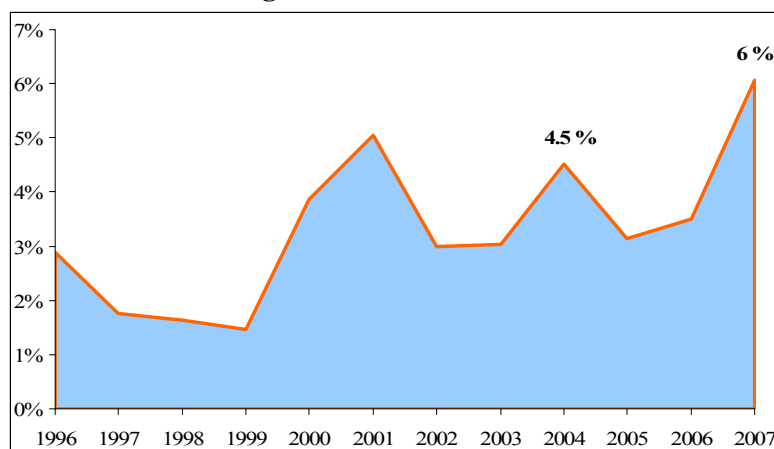


Source: IMF

Yet, Albania's FDI attractiveness remains modest, to say the least, with the exception of some major strategic privatizations in selected recent years. FDIs peaked in 2004 and 2007, because of the privatization of two important state owned companies in the banking and the telecommunication sector.

<sup>14</sup> World Bank , Country Ec Mem, pg. 22 [Table 7: Albania Growth Accounting Results]

### Net Foreign Direct Investments to GDP



Source: EBRD

In 2004, the level of FDI reached the amount of 341 Mln. USD when the Austrian Raiffeisen Zentralbank (RZB) acquired full ownership of the Albanian Savings Bank for 126 Mln. USD. FDI boosted again in 2007 after the Albanian government sold 76 percent of the state owned fixed telephony company, Albtelecom, to a Turkish consortium Çalik Enerji Telecommunications for over 160 Mln. USD.

Italy and Greece are the predominant sources of FDI in Albania, with roughly 48 percent originating in Italy and 34 percent in Greece.<sup>15</sup> These two countries are also Albania's major trading partners for both import and export. Foreign investments are concentrated mostly in commercial cities, with approximately two-thirds of all FDI targeted toward either the capital, Tirana, or the main cargo port of Durrës.

Some of the constraints that the foreign investors face while entering the Albanian market are weak and often conflicting property rights that seriously hamper their transactions.<sup>16</sup> Meanwhile low labor and transportation costs have been indicated from the survey as key advantages of investing in Albania.

As TFP growth deriving from post-transition reallocation draws to a close, it will become increasingly important for Albania to generate TFP improvements from alternative sources. **Educational attainment** is one such alternative source of TFP improvements.

Even after 17 years, the Albanian education system's organizational structure and overall quality lives a lot to be desired. Education policies have been unable to develop alongside the rapidly changing economic environment. The period was characterized by a noticeable increase in school drop-out rates as supportive education policies, necessary to efficiently upgrade from the previous system, have been completely non-existent. In

<sup>15</sup> World Bank, Benchmarking FDI Opportunities, Investment Horizons: Western Balkans (2006)

<sup>16</sup> Policies for business in the Mediterranean Countries, Albania, Centre for Administrative Innovation in the Euro-Mediterranean Region

comparison with its neighbors, Albania is considered to be one of the countries that suffered most severely from inadequate education policies during the transition period.

#### Education of 18-24 age group

Year 2005	Percentage of age group 18-24 that have not finished high school and do not follow any other educational or training process
<b>Albania</b>	<b>61.9</b>
Kroatia	5.4
Macedonia	36.2
Serbia	11.4
Lisbone's Objective for 2010	10.0
EU-(15 countries) average	17.3

*Source: European Commission (2006)*

The fact that approximately 62 percent of Albania's youth has not completed secondary education and is not currently enrolled in any alternative educational or training program is a clear indicator that the policymakers have failed to utilize the proper channels and to harness the right tools to adopt the education system to contemporary challenges. These numbers, however, also bring to light the fact that Albania currently holds an unexploited resource in its hands – the youth workforce potential is vast and, if harnessed, could exert positive effects upon the nation's human capital.

Another important determinant of TFP is the degree of *trade integration*, which allows an economy to specialize in the production of those products in which its relative productivity is highest and also facilitates the transfer of technology and ideas from other more advanced economies. Albania's real growth in total trade of goods and services has decelerated from an average of 18.1 percent in the early 2000s to 8.6 percent in 2007, being positioned below the Europe and Central Asia countries average. Albania's trade integration ratio remains substantially low, declining slightly to 68.8 percent of GDP in 2007. Services, including tourism, accounted for about 65 percent of Albania's total exports in 2007. This is noticeably different from similar countries, for which goods dominate their exports with more than 75 percent of the total. These facts show that there is a lot to be done in understanding the specific comparative advantages of the Albanian economy and setting up adequate stimulating policies in order to improve the country's trade integration. Such instruments will also help narrowing the trade deficit, which, in combination with a potential decline in remittances, could pose extreme risks not only to output growth of the economy but also to its overall economic stability.

However, a potentially positive factor in this perspective is Albania's proximity to the massive EU market. European countries are the destination of 85 to 90 percent of Albanian exports. Imports are primarily obtained from Italy, Greece, and Turkey. As the European Union is its main export market, Albania has a very favourable market access thanks to the uniform Autonomous Trade Preference scheme, which provides duty and quota free access for practically all Albanian exports to the EU markets, and the Stabilization and Association Agreement with the EU signed by Albania in 2006. In addition to these arrangements, Albania, which is a member of the WTO, has also

recently ratified the Central Europe Free Trade Agreement (CEFTA) in 2007 as well as an FTA with Turkey that entered into force in May 2008.

Therefore, deeper trade integration is favourable to be pursued by Albania. Priority sectors and policy areas must be identified in order to stimulate Albanian exports targeting both the Western Balkans and also the EU market. Given the existence and complexity of non-trade barriers in the European Internal Market, perhaps a more reasonable short to medium term policy approach would be the one attempting to intensify trade integration with the countries of the region. However, in the long term the Albanian economy must necessarily aim at preparing to confront the spiky competitive pressures present in the European markets, since European Union membership is already a firm objective for the country.

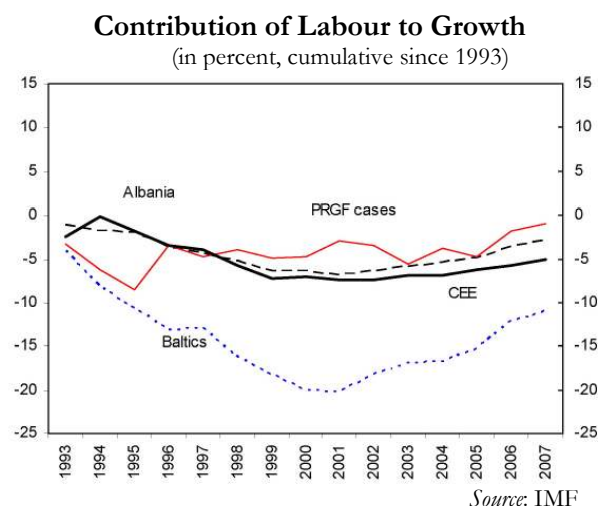
The region of the Western Balkans offers some specific characteristics that make it particularly well suited for regional trade integration. First, all the Western Balkans countries strive for EU membership and are required by the Union to converge towards the same regulatory framework. Second, the region comprises mostly small economies which would benefit from participation in a larger regional market, and therefore enhance their potential for economies of scale in production processes. Montenegro's and Kosovo's independence further added to the number of small economies. Third, most countries used to be part of the same bloc and some economic gains could be reaped from (re)integrating fragments of infrastructure systems. Last, but not least, the geographic, ethnic and cultural similarities can play a positive market integration role. The current politics in most of these countries attempt to emphasize the differences between these societies. Nevertheless, from the perspective of a citizen of the Balkans, I can personally testify the great similarities in consumption preferences that could potentially offer an enormous advantage in deepening the integration of markets.

The fourth TFP determining factor is the *institutional quality*. Stable and responsible institutions could reduce transaction costs and stimulate the private sector to concentrate on products and sectors in which the economy is naturally most productive. Unfortunately, developing such institutions has proven to be a complex challenge for Albania over the entire transition period. The establishment of a functioning democratic system is still a process that, although with the strict supervision and assistance from important international institutions and actors, continues to represent one of Albania's most serious challenges. To put this in context, Albania has not yet been able to organize non-contested free and fair elections that comply with international standards.

Notwithstanding the difficulties, once again, proximity to the EU and the focus of the international community on the stability of the region constitutes a major pull towards improving the domestic institutional environment. In April 2008, Albania was officially invited, together with Croatia, to join the North Atlantic Treaty Organization, and the end of next year might find these countries being full members of the organization.

When it comes to labour, for Albania, as in other transition economies, labour was not a major factor of growth. This is partly justified from high labour mobility to neighbouring advanced economies, but also by hidden labour inputs in the large informal sector. The

size of the informal economy in Albania is believed to exceed by 30 percent of its formal economy<sup>17</sup> and its undeclared household income was estimated at 52 percent of GDP only few years past, the largest among SEE and CEE countries.<sup>18</sup>



Sustained growth rates have led to very modest job creation, although the official rate of unemployment appears to have fallen to slightly above 13 percent in 2007. Some of the reduction in unemployment is due to a reduction in active job search, as evident in the contraction of the labour force during most of the years, presented in the following table. According to INSTAT's interpretation, this drop in labour force is largely as result of the increasing number of working age inactive people, especially housekeepers.

However, most experts believe that the labour market data are not very accurate as they all come from the same and only source, which is the administrative source. Given the size of informality, the lack of incentives for people to register in the employment offices and, above all, the political sensitivity of these kinds of figures, there can be a number of questions raised in regards to their accuracy.

<b>Labour Market Indicators</b>										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Labour force										
<i>percentage change from previous year</i>	1.5	-1.1	-1.7	-14.2	-0.8	-0.3	-0.1	-0.3	0.0	-0.6
Employment										
<i>percentage change from previous year</i>	-2.0	-1.8	0.3	-13.9	0.0	0.7	0.5	0.1	0.3	0.1
Unemployment										
<i>percent of labour force</i>	17.8	18.4	16.8	16.4	15.8	15.0	14.4	14.1	13.8	13.3

Source: EBRD, Transition Report 2007

<sup>17</sup> OECD, The informal economy in Albania: Analysis and Policy Recommendations, (2005), pg.12.

<sup>18</sup> World Bank Country Economic Memorandum, *Albania - Sustaining Growth Beyond the Transition*, PREM Unit, ECA Region, Report No. 29257-AL, (2005), pg.120.

In any case, one thing which can be clearly observed is that despite impressive expansion of the Albanian economy over the past years, not enough jobs are being created. According the World Bank, only between 2002 and 2004, 15 percent of the unemployed and 10 percent of those who were out of the labour force made the transition to formal sector employment. By contrast 38 percent of the unemployed found jobs in the informal sector during the same period.<sup>19</sup>

#### Annual Gross Salary or Wages for Various Labour Categories

(in USD)

	Management	Professional	Technical	Skilled Labour	Unskilled Labour
Albania	13,538	8,123	6,497	3,569	2,215
B & H	22,521	14,250	12,600	7,667	5,467
Croatia	35,383	22,317	12,600	11,408	7,714
Serbia & Mont.	NA	10,649	3,878	5,715	4,293
Czech Republic	21,193	NA	6,031	9,389	6,583
Hungary	37,170	NA	16,862	8,744	7,618
Slovakia	21,189	NA	10,797	5,152	3,699

Source: World Bank <sup>20</sup>

While cheap labour costs may have been an advantageous competitive feature of the Albanian economy, upward pressures on wages are mounting as indicated by increased earnings. Albania still has some of the lowest wages in the region, despite its strong economic growth. The still underexploited labour contribution to growth combined with the low cost of labour could prove to be a competitive advantage for Albania in the regional context. Several analyses of the sector show evidence for an underexploited contribution of labour in the productivity of the country's economy. The situation could be turned around if proper stimulating policies are put in place, combining the low labour cost advantages with adequate policies in education and training, which would also improve the skills of the country's labour force.

<sup>19</sup> World Bank, *Albania: Labor Market Evaluation*, Report No. 34597-AL (2006), pg.78.

<sup>20</sup> World Bank, *Investment Horizons: Western Balkan*, 2006.



### **How sustainable are these growth trends? Challenges ahead.**

The Albanian economy has performed positively over the past years and it will potentially continue its strong economic performance while the country advances towards its goal of European integration. However, the country's economic growth and competitiveness remain constrained by some potential risks linked to the specific nature of the Albanian economy. Additionally, the current global economic situation does not favor transition economies, and the Albanian economy is especially exposed given its financial dependence from emigrants residing in economies that either are or are soon expected to be hit by a slowdown. These traits and the coming electoral year could make macroeconomic and financial stability harder, all the more so if tight budget policies were to be relaxed.

Some threats to the Albanian economic stability have already been present for a period of time and are supposedly been considered by the policymakers for retrieval. Low levels of exports, modest private and foreign investments, weak institutions, and bottlenecks in infrastructure sectors are issues that have dominated the debate about the future developments of the country's economy. Despite repeated attempts, turning around the loss-making electricity sector and realizing its potential has proved elusive over the entire transition period.

In terms of factors influencing growth that could pose an immediate risk to the economic stability is the economy's excessive reliance on remittances. Remittances have been fuelling the performance of this country with almost 1,000,000 Albanians employed internally and approximately 700,000 emigrants exercising their economic activity abroad. Financing of the trade deficit has depended largely on remittances, estimated in 2006 to amount for 55 percent of the trade deficit. Nevertheless, Albania suffers from large current account deficits. Significant inflows of current transfers and positive service balances in recent years have helped dampen the rising trade deficits. Imports have steadily grown reaching 49 percent of GDP in 2007 with exports lagging behind at 23 percent of GDP leaving Albania with a trade deficit of 26 percent. However, remittances cannot constitute a solid basis for long term economic development. Based on the country's competitive advantages, supportive policies and instruments must be put in place in order to intensively stimulate its exports.

Some concerns can be raised in regards to the financing of the country's investment needs. Albania's graduation from IDA<sup>21</sup> eligibility, which has until present supplied preferentially rated financing, as well as expectations to access international capital markets, pose another major challenge. Although the public debt to GDP ratio has been substantially reduced over the recent years, it still remains over 50 percent of the GDP. Further fiscal consolidation, advances in fiscal and debt management, and deeper financial markets are required as Albania moves away from concessional finance and starts accessing international capital markets. As the IMF's role is expected to be reduced after the Program comes to an end in two months time, alternative anchors for policies must be found.

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<sup>21</sup> International Development Association, the World Bank's poverty reduction wing.



A reasonable option for such an anchor could be the European institutions, since both the EU and Albania have committed to a potential membership of the country in the Union. Albania was the first of the countries of the region to start negotiations with the EU for signing a Stabilization and Association Agreement in 2003.

The Agreement was signed in June 2006, denoting the country's first major step toward EU accession. The Interim Agreement, which mostly covers SAA provisions related to the free movement of goods and services, is in force since December 2006 and its implementation is continuing smoothly. Last March, the EU Troika noted the country's progress pursuant to the Interim Agreement and it welcomed, amongst other aspects, Albania's achievements in its economic reforms.

From 2001 to 2007, the Assistance for Reconstruction, Development and Stabilization (CARDS) programme has served as the main EC financial instrument for Albania. Until 2006, total CARDS assistance allocated to Albania amounted to 282 million EUR. As of January 2007, the CARDS programme has been replaced by the new Instrument for Pre-Accession Assistance (IPA), under which Albania will receive a total amount of 212 Mln. EUR from 2007 till 2009.

However, in contrast to its more outspoken competitor countries of the region, Albania has not yet handed in an official request for joining the European Union. In April 2008, just after the signing of a conditional SAA, the Serbian President Boris Tadic, told a press conference in Luxemburg that Serbia aims "to become an official candidate by the end of the year." During a recent meeting with EU Enlargement Commissioner Olli Rehn, the Deputy Prime Minister of Montenegro, Gordana Durovic, announced that Montenegro intends to officially apply for EU membership by the end of this year. Macedonia has obtained the candidate country status since 2005, while Turkey has continued to push its case, as has Croatia, with great success since 2002.

It is time for Albania and its leaders to defeat their current timidity and to set themselves and the country an ambitious goal. Albania needs to find a way to express politically the strong social consensus concerning its EU membership aspiration. The political class must stop saying *to itself* that it wants to join the EU and take the most essential, basic, logical first step: to announce its intention and the commitment of its people to other Europeans and EU institutions.

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**AGENDA Institute** was founded in 2006 as a *think tank*, non-governmental, independent organization which operates in the areas of Good Governance, European Integration and Neighbourhood European Policies, and Policies for Social and Economic Development.

### ***Mission***

- To encourage and empower currently democratic experiences, by promoting democratic values during the debate processes, analyses and of the public policies implementation in the country.
- Making the process of policy-making less politicized, by offering to the policy-makers key information based in researches.

### ***Groups of Interes***

- Public
- Policy-makers
- Media
- Business Community

### ***Researches Areas***

- Good Governance
- European Integration and Neighborhood Integration Policies
- Policies for Social and Economic Development

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